**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

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# FORM 10-QSB

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_X_ Quarterly report under section 13 or 15(d) of the Securities Exchange Act of 1934

**For the quarterly period ended July 31, 2001**
or
___ Transition report under section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _________ to _________

**Commission File Number 0-25868**

**CONTROLLED ENVIRONMENT**
**AQUACULTURE TECHNOLOGY, INC.**
(Exact name of small business issuer as specified in its charter)

| | |
|---|---|
| **Colorado** | **84-1293167** |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |

**1000 Bishop Street, Suite 303**
**Honolulu, Hawaii 96813**
(Address of principal executive offices)

**(808) 836-3707**
(Issuer's telephone number)

**None**
(Former name, former address and former fiscal year, if changed since last report)

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Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the past 12 months (or for such shorter period that the issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes _X_ No ___

As of July 31, 2001 there were 7,426,272 shares of the issuer's common stock outstanding.

Transitional Small Business Disclosure Format Yes ___ No _X_

**PART I -- FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**Controlled Environment Aquaculture Technology, Inc. and Subsidiaries**
**Consolidated Balance Sheet**
**(unaudited)**

| **Assets** | **July 31, 2001** |
|---|---|
| Current assets | |
| Cash and cash equivalents | $ 124,862 |
| Accounts receivable, net | 477,420 |
| Inventory | 1,143,826 |
| Other current assets | 53,620 |
| Total current assets | 1,799,728 |
| Property, plant and equipment, net | 7,487,829 |
| Total assets | $ 9,287,557 |

**Liabilities and Stockholders' Equity**

| | |
|---|---|
| Current liabilities | |
| Accounts payable | $ 694,760 |
| Current portion of long-term debt | 373,005 |
| Other accrued expenses and liabilities | 282,201 |
| Total current liabilities | 1,349,966 |
| Long-term debt | 2,361,177 |
| Convertible subordinated debentures, net of beneficial conversion feature | 2,100,505 |
| Stockholder's equity | |
| Common stock, no par value, 100,000,000 shares authorized, 7,426,272 issued and outstanding | 8,835,866 |
| Additional paid-in capital | 1,371,652 |
| Retained deficit | (6,731,609) |
| Total stockholders' equity | 3,475,909 |
| Total liabilities and stockholders' equity | $ 9,287,557 |

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Operations**
**(unaudited)**

| | Three Months Ended July 31, 2001 | Three Months Ended July 31, 2000 | Six Months Ended July 31, 2001 | Six Months Ended July 31, 2000 |
|---|---|---|---|---|
| Sales | $ 869,891 | $ 509,969 | $ 1,324,615 | $ 1,146,813 |
| Cost of sales | 992,072 | 515,327 | 1,494,807 | 1,168,146 |
| Gross margin | (122,181) | (5,358) | (170,192) | (21,333) |
| General and administrative expenses | 220,481 | 273,117 | 588,238 | 562,235 |
| Loss from operations | (342,662) | (278,475) | (758,430) | (583,568) |
| Other income | - | 4,000 | 7,501 | 19,392 |
| Interest income | 120 | 4,368 | 2,919 | 8,348 |
| Interest expense | (114,775) | (103,592) | (200,054) | (175,524) |
| Net loss | $ (457,317) | $ (373,699) | $ (948,064) | $ (731,352) |
| Basic and diluted net loss per common share | $ (0.06) | $ (0.09) | $ (0.13) | $ (0.17) |

The accompanying notes are an integral part of these consolidated financial statements.

**Consolidated Statements of Cash Flow**
**(unaudited)**

| | Six Months Ended July 31, 2001 | 2000 |
|---|---|---|
| Operating activities | | |
| Net loss | $ (948,064) | $ (731,352) |
| Adjustments to reconcile net loss to net cash used in operating activities | | |
| Depreciation | 232,183 | 166,370 |
| Non-cash interest expense - convertible debt | 13,832 | - |
| Other | 12,000 | - |
| Net changes in operating assets and liabilities | | |
| Accounts receivable | (299,007) | (19,051) |
| Inventory | (372,535 | (104,236) |
| Other current assets | 7,482 | (122,308) |
| Accounts payable | (33,336) | (116,413) |
| Accrued expenses and other liabilities | 112,447 | (3,495) |
| Net cash used in operating activities | (1,274,998) | (930,485) |
| Investing activities | | |
| Capital expenditures | (2,150,445) | (248,282) |
| Net cash used in investing activities | (2,150,445) | (248,282) |
| Financing activities | | |
| Proceeds from issuance of common stock | 1,325,000 | - |
| Use of restricted cash for revolving line of credit | 250,000 | 79,293 |
| Principal payment on revolving line of credit | (235,000) | - |
| Proceeds from issuance of convertible debentures | 2,250,000 | 900,000 |
| Proceeds from issuance of debt | 82,020 | 125,000 |
| Principal payments on long-term debt | (195,074) | (23,557) |
| Net cash provided by financing activities | 3,476,946 | 1,080,736 |
| Change in cash and cash equivalents | 51,503 | (98,031) |
| Cash and cash equivalents at beginning of period | 73,359 | 213,935 |
| Cash and cash equivalents at end of period | $ 124,862 | $ 115,904 |

The accompanying notes are an integral part of these consolidated financial statements.

**Controlled Environment Aquaculture Technology, Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements**

**(unaudited)**

**1. Basis Of Presentation**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-QSB and Item 310 of Regulation S-B. In the opinion of management, all adjustments (consisting of only normal recurring accruals) necessary for a fair presentation have been included. The results of operations for the quarters and six months ended July 31, 2001 are not necessarily indicative of results that may be expected for the year ending January 31, 2002 or for any future periods.

These consolidated financial statements and related notes should be read in conjunction with the audited consolidated financial statements and related notes for the year ended January 31, 2001, which are contained in the Company's Annual Report on Form 10-KSB filed with the Securities and Exchange Commission (SEC) on May 16, 2001.The consolidated financial statements include the accounts of Controlled Environment Aquaculture Technology, Inc. and its wholly owned subsidiaries, Ceatech HHGI Breeding Corp., Ceatech Plantations, Inc., Sunkiss Shrimp Co., Ltd., and Hawaii High Health Seafood Corp. Significant intercompany transactions and amounts have been eliminated in consolidation.

**2. Going Concern**

The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles, which contemplate continuation of the Company as a going concern. The Company has sustained net losses since inception, and, therefore, in accordance with generally accepted accounting principles; doubt must be expressed regarding the Company’s continuing viability. For the quarter ended July 31, 2001, the Company incurred a net loss of $457,317, and as of July 31, 2001, the Company had a retained deficit of $6,731,609, which raises substantial doubt as to the Company’s ability to continue as a going concern. In addition, the Company used cash in operations of $1,274,998 and used cash for investing activities of $2,150,445 during the six months ended July 31, 2001.

The Company believes that its initial twenty growout ponds do not produce sufficient amounts of shrimp to generate positive cash flow. Consequently, construction has begun on an additional twenty ponds for which up to $3.9 million in financing has been obtained in the form of Dual Rate Convertible Debentures.

**3. Long-term Debt**

The Company has a loan payable to Bank of America, collateralized by the ponds, buildings and improvements, guaranteed by the United States Department of Agriculture, due in monthly payments with interest payable at prime plus 2%. The maturity date is April 2007. Among other things, the Company is not permitted to declare or pay dividends during the term of the loan, is not permitted to acquire treasury stock or make cash transfers to shareholders, must maintain a tangible net worth of $2 million and must maintain a ratio of total senior liabilities to total net worth of not greater than 1.7 to 1.

In June 1999, the Company entered into an installment sale contract with Pacific Machinery, Inc. for the purchase of electricity generating machinery. This installment loan was provided by Caterpillar Financial Services Corporation, is collateralized by the generators purchased, and is repayable in monthly installments of $2,030.

In April 2001, the Company entered into a similar installment sale contract with Pacific Machinery, Inc. This installment loan is also collateralized by the machinery purchased and is payable in monthly installments of $2,278.

**4. Convertible Subordinated Debentures**

In February 2001, the Company received commitments for up to $3.9 million in additional financing. The commitments are in the form of subscription agreements to purchase Dual Rate Convertible Debentures to be issued by the Company. Each of the subscribers is an existing shareholder of the Company.

The Company expects to use the proceeds from sale of these debentures for capital improvements including construction of twenty one-acre growout ponds and two half-acre nursery ponds, to construct additional facilities and purchase additional equipment for the Company's hatchery and processing facility, and for working capital.

All of the subscribers have deposited in escrow all of the funds required to purchase the debentures. The Company may draw on the funds at such times and in such amounts as it may determine, at any time until March 1, 2002. As the Company draws against the funds deposited in escrow, it will be required to issue one or more debentures to the subscribers that correspond in principal amount to the amount of its draws. The Company currently believes that it will draw the full $3.9 in principal amount available to it before March 1, 2002, but any portion of the funds not drawn by the Company on or before March 1, 2002, will be returned to the subscribers.

All debentures that are issued will bear interest at the rate of 11.5% per annum from the date of issuance through March 1, 2002. Thereafter, the annual interest rate on outstanding debentures will be reduced to 3.0%. All interest earned from the date of issuance of a debenture through March 1, 2002, will be deferred and will be payable only upon redemption or through conversion into shares of the Company's common stock. Interest earned on outstanding debentures after March 1, 2002, will be payable quarterly by the Company, in arrears, and may not be deferred or converted into shares of common stock. Pursuant to the terms of the subscription agreements, the debentures are issuable in various denominations ranging from $25,000, or multiples thereof, to $100,000, or multiples thereof. The holders of the debentures have the right to elect to convert the full principal amount of their debentures together with all accrued interest from the date of issuance through March 1, 2002, into shares of the Company's common stock. In the event that all $3.9 million of the debentures are issued and, subsequently, all of the principal amount, together with accrued but unpaid interest through March 1, 2002, is converted into shares of common stock by the holders, the maximum number of shares the Company will be required to issue upon conversion would be approximately 6,100,000 shares at an average price of approximately $0.64 per share. Upon issuance, the shares will constitute “restricted securities” as defined in Rule 144 under the Securities Act of 1933.

The outstanding debentures will be subordinate to the prior repayment by the Company of its loan from Bank of America Community Development Bank having a principal balance of $2,607,454 as of July 31, 2001, which loan was originally made on or about October 20, 1998. Subject to this subordination restriction, the debentures are redeemable at the option of the Company, at any time before conversion, at a price equal to the total of 100% of their face amount plus all accrued and unpaid interest up to the date of conversion. If not previously converted or redeemed, the Company will be required to redeem all outstanding debentures on March 1, 2007. As of July 31, 2001, the Company had Dual Rate Convertible Debentures issued and outstanding in the principal amount of $2,250,000. The Company has determined that these outstanding debentures had a beneficial conversion feature amounting to $1,163,327. The beneficial conversion feature represents the intrinsic value, the excess of the Company’s stock price over the conversion price, as of the date the debenture is issued. This beneficial conversion feature has been recognized as a discount to the Dual Rate Convertible Debentures and as additional paid-in capital. This discount will be accreted over the term of the debenture agreement using the interest method. Such accretion amounted to $13,832 for the quarter ended July 31, 2001.

**5. Stockholders’ Equity**

The Company has authorized 100 million shares of no par value common stock. Each share entitles the holder to one vote. There are no dividend or liquidation preferences, participation rights, call prices or rates, sinking fund requirements, or unusual voting rights associated with these shares. As of July 31, 2001, the Company had 7,426,272 shares of common stock outstanding.

At quarter end, the Company also had outstanding 2,760,149 Class A Common Stock Purchase Warrants exercisable at $2.00 per share on or before December 31, 2001 (“Warrants”). Pursuant to the provisions contained in putative documentation governing the issuance and terms of the Warrants, the Company gave notice of cancellation of the Warrants to be effective as of September 18, 2000. Subsequently, issue was taken with the Company’s authority to cancel the Warrants based on provisions set forth in another version of the governing documentation, and, without the authorization or approval of management, a notice dated October 13, 2000 advising that the Warrants were not cancelled was unilaterally written and sent to warrant holders by the Company’s stock transfer agent. Management has not yet been able to determine which of the alternate controlling documentation is actually effective. To date no notice of an attempted exercise of Warrants has been received.

The Company has authorized 10 million shares of preferred stock. Under the terms of the Articles of Incorporation, the Board of Directors may issue preferred stock for any proper corporate purpose. In approving any issuance, the Board has the broad authority to determine rights, privileges, and preferences of the preferred stock, which may be issued as more than one class or series. The rights, privileges, and preferences may include voting, dividend, conversion, redemption, participation, and liquidation rights. As of July 31, 2001, there is no preferred stock issued or outstanding.

As of July 31, 2001, approximately 3.8 million shares of common stock were reserved for issuance under the convertible debentures and common stock warrants.

## 6. Loss Per Share

Losses per share calculations are in accordance with SFAS No. 128, “Earnings Per Share.” “Basic” earnings (loss) per share are calculated by dividing net income (loss) by the weighted average number of common shares outstanding for the year. “Diluted” earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding plus the dilutive effect of outstanding common stack warrants and convertible debentures. The basic and diluted earnings per share calculations are the same because potential dilutive securities would not have been dilutive for the periods presented. Net loss per share is computed as follows:

| | Three Months Ended July 31, | | Six Months Ended July 31, | |
|---|---|---|---|---|
| | 2001 | 2000 | 2001 | 2000 |
| Net loss | $ (457,317) | $ (373,699) | $ (948,064) | $ (731,352) |
| Weighted average common shares | 7,423,489 | 4,355,450 | 7,232,493 | 4,355,450 |
| Basic and diluted net loss per common share | $ ($0.06) | $ ($0.09) | $ (0.13) | $ (0.17) |

## 7. Dividends

The terms of the loan from Bank of America restrict the declaration and payment of dividends while the loan is outstanding. The loan is due and payable in April 2007.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion contains certain statements that may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Any statements that refer to expectations, projections or other characterization of future events or circumstances, and especially those which include variations of the words "believes", "intends", "estimates", "anticipates", "expects", "plans", or similar words or variations thereof, are likely to be forward-looking statements, and as such, are likely to concern matters involving risk, uncertainty, unpredictability and other factors that could materially and adversely affect the outcome or results indicated by or inferred from the statements themselves. Therefore, the reader is advised that the following discussion should be considered in light of the discussion of risks and other factors contained in this Form 10-QSB and in the Company's other filings with the Securities and Exchange Commission, and that no statements contained in the following discussion or in this Form 10-QSB should be construed as a guarantee or assurance of future performance or future results.

**Overview**

The results of farm operations during the quarter ended July 31, 2001 show that operational changes were successful in reversing the lower than expected growth rates and pond yields which occurred in the fourth quarter of fiscal year 2000 and continued into the first quarter of fiscal year 2001. Farm shrimp growth rates in the second quarter were generally higher than the highest growth rates ever achieved even before the unexpected slowdown experienced in the prior two quarters, and the distribution of harvested shrimp among market size categories improved significantly in the direction of the larger, higher value sizes. In addition, the new processing facility in Hanapepe, Kauai became fully operational in June 2001, and the Company gained the ability to harvest ponds strictly on the basis of product readiness for the market and demand.

Construction of the additional twenty one-acre growout ponds and two half-acre nursery ponds at the farm's present Kekaha Agriculture Park location proceeded apace during the quarter. The nursery ponds and eight of the new growout ponds were completed and placed in service during the quarter. Six more growout ponds were substantially complete at July 31, 2001. It is anticipated that construction and stocking of the remaining ponds will be finished by the early part of the fourth quarter 2001.

The Company continued its efforts to obtain the rights to suitable portions of several thousand acres of State owned land adjacent to and in the immediate vicinity of the farm. These lands were formerly devoted to sugar cane. The Company has a short-term revocable permit for the use of 246 acres of this land, which is located directly across the street from the present farm site and is the best available land for efficient expansion of the farm beyond the Kekaha Agriculture Park. If and when the Company actually commits to a long-term use of this property for its farm operations, it is contemplated that the revocable permit will be converted into a long-term lease. The Company also continued its active participation in discussions and planning meetings with the State of Hawaii concerning the best transitional and long-term uses of the vacated lands and the best means of maintaining and reconfiguring the infrastructure and vital utility services necessary to support such uses in the near and long term. Management remains reasonably confident that it will be able to secure enough of this land to accommodate all expansion in the foreseeable future.

**Results of Operations**

General

Since its inception in January 1995, the Company has sustained cumulative net losses of approximately $6.7 million. Such losses have been financed through a combination of internally generated funds, funds provided by stockholders and investors, and funds provided by loans from financial institutions. Based on current shrimp production levels and near-term projected sales revenue, the Company will be required to obtain additional financing in order to continue to fund losses until such time as expanded production facilities are operational.

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. As shown in the consolidated financial statements for the six months ended July 31, 2001 and 2000, the Company incurred net losses of approximately $948,000 and $731,000, respectively. In addition, the Company currently has no commitment for outside capital to fund farm expansions beyond forty production ponds. These factors, among others, may indicate that the Company will be unable to continue as a going concern for a reasonable period.

The consolidated financial statements do not include any adjustments relating to the recoverability of assets and classification of liabilities that might be necessary should the Company be unable to continue as a going concern. The Company's continuation as a going concern is dependent upon its ability to generate sufficient cash flow to meet its obligations on a timely basis, to comply with the terms of its existing loan agreement, to obtain additional financing or refinancing as may be required, and ultimately to attain positive operating cash flow. The Company is actively pursuing plans for additional financing through, among others, an equity offering, additional debt financing, or some combination thereof. See Liquidity and Capital Resources below for further discussion.

Product Sales

The Company's revenue from shrimp sales for the second quarter ended July 31, 2001 was approximately $870,000 compared to approximately $510,000 for the second quarter ended July 31, 2000. During the second quarter, the Company sold approximately 148,000 net pounds of farm shrimp as compared to 86,000 net pounds of farm shrimp in the second quarter of 2000. Revenue from the sale of farm shrimp during the second quarter of 2001 increased primarily as a result of higher shrimp growth rates and pond yields and completion of the Company's new processing facility.

The Company's revenue from shrimp sales for the six months ended July 31, 2001 was approximately $1,325,000 compared to approximately $1,147,000 for the six months ended July 31, 2000. During the first six months of fiscal year 2001, the Company sold approximately 222,000 net pounds of farm shrimp as compared to 196,000 net pounds of farm shrimp in the first six months of fiscal year 2000. Revenue from the sale of farm shrimp during the first six months of fiscal year 2001 increased primarily as a result of higher shrimp growth rates and pond yields and completion of the Company's new processing facility in June 2001.

Cost of Sales

Cost of sales for the second quarter of 2001 was approximately $992,000 compared to $515,000 in the second quarter of 2000. The Company continued to generate losses at the gross margin level primarily for two reasons: first, revenue from twenty production ponds is insufficient to cover all costs associated with the production of the shrimp; and second, all costs associated with production include allocated indirect costs such as deprecation expense and overhead.

Cost of sales for the six months ended July 31, 2001was approximately $1,495,000 compared to $1,168,000 for the six months ended July 31, 2000. The Company continued to generate losses at the gross margin level during the first six months of fiscal year 2001 primarily due to insufficient revenue from twenty production ponds to cover all costs associated with the production of the shrimp in addition to allocated indirect costs associated with production including deprecation expense and overhead.

General and Administrative Expenses

General and administrative expenses for the second quarter ended July 31, 2001were $220,481compared to $273,117 in the second quarter of fiscal year 2000. General and administrative expenses for the second quarter of fiscal year 2001were lower than in the second quarter of fiscal year 2000 primarily because of legal expenses incurred during last year's second quarter in connection with the conduct of litigation with a former employee.

General and administrative expenses for the six months ended July 31, 2001 were $588,238 compared to $562,235 for the six months ended July 31, 2000. General and administrative expenses for the first six months of fiscal year 2001 were higher than in the first six months of fiscal year 2000 primarily because of expenses incurred during the first quarter of 2001in connection with litigation with a former employee.

**Liquidity and Capital Resources**

In April 2001, the Company received commitments from existing shareholders for up to $3.9 million in additional financing. The commitments are in the form of subscription agreements to purchase Dual Rate Convertible Debentures. The subscribers have deposited the funds in an escrow account. The Company may draw on the funds at such times and in such amounts as it may determine at any time until March 1, 2002.

The Company expects to use the proceeds from sale of the debentures for capital improvements including construction of twenty one-acre growout ponds and two half-acre nursery ponds, to construct additional facilities and purchase additional equipment for the Company's hatchery and processing facility, and for working capital. During the quarter ended July 31, 2001, the Company had draws from escrow totalling $1,950,000 and issued debentures in that principal amount.

**Certain Factors That Might Affect Future Results**

The Company's operating results and financial condition have varied in the past and may vary significantly in the future due to changes or variations in a number of factors beyond the Company's ability to control or anticipate. Hence, the descriptions and accounts of the Company and its business as set forth herein include forward looking statements that involve matters of considerable risk and uncertainty. The following factors, among others, could cause actual results to differ materially from those contained in the forward looking statements made in this report and presented elsewhere by management from time to time. Such factors, among others, may have a material adverse effect upon the Company's business, results of operations and financial condition.

The uncertainty of being able to acquire land to accommodate additional expansion of the Company's farm operations poses risks for the business, which will vary according to the Company's need for and scope of expansion. The existing twenty production pond operation and ongoing expansion to forty production ponds is located entirely within the State owned Kekaha Agricultural Park. The Company leases this land from the State of Hawaii Department of Agriculture for a term of forty-five years. For future expansion, the best available land is the abundant acreage adjacent to the Agricultural Park previously devoted to sugar cane but now abandoned and largely unused. Leasehold, infrastructure and utility costs and the requirements for obtaining land use approval and permits will be significant factors in determining the ultimate feasibility of expanding into these lands. The risk of competition for acquisition of these lands is mitigated by the lack of other economically viable long-term uses, but inability to obtain portions of these lands could have a material adverse effect on the Company's financial condition.

The geology, location and climate of Hawaii present certain risks of natural disasters such as hurricanes, volcanic eruptions, flooding, and tsunamis. For example, in 1992 Hurricane Iniki caused substantial damage on the island of Kauai. Though the Company was not operating during Hurricane Iniki, prototype ponds that were in existence at the time sustained little damage during the storm. The majority of the Company's infrastructure consists of low profile basins that present little vertical relief, and could be expected to survive exposure to hurricane winds, although no assurance can be made that such infrastructure would survive. The Company's hatchery building is designed to survive winds of up to 140 mph and provisions have been made to direct storm waters from adjacent lands into existing drainage ditches. Nevertheless, if natural disasters such as hurricanes or severe storms occur on Kauai, the Company's operations and financial condition may be adversely affected.

The business of the Company is subject to substantial local, state and federal regulations, including, but not limited to, occupational health and safety standards, food product health and safety regulations, archaeological preservation laws, and environmental regulations. The Company believes that it has acquired all necessary permits and licenses for its animals, seawater wells, pumps, ponds, and buildings constructed to date. However, there is no assurance that the Company will be able to obtain any additional permits or licenses that may be required in the future. Although the Company is not aware of any environmental compliance issues, there is no assurance that such issues will not arise in the future and have a material adverse effect on the Company's operations.

The Company's farm operations are located on sites formerly used in agriculture operations, which involved the extensive use of pesticides and other agriculture chemicals. Waterproof lining of the Company's ponds and the use of seawater taken from below the freshwater groundwater sources where residual agriculture chemicals may temporarily reside is believed to prevent any reasonable likelihood of product contamination by such chemicals. Tests have confirmed the absence of such pesticides in the incoming water. In October 1999, the Hawaii State Department of

Health granted the Company a permit for discharge of farm effluent to the ocean. This Permit is valid through April 2004 and allows a discharge volume to support a farming operation consisting of 100 ponds. The recently completed processing/freezing facility in Hanapepe, Kauai required approval of a facility design permit from the Department of Health. Although management is not currently aware of any environmental or health regulation compliance issues that will materially affect the Company's operations in an adverse way, there is no assurance that such compliance issues will not arise in the future.

The Company's senior personnel include persons widely acknowledged as authorities in the field of shrimp aquaculture and high health shrimp breeding and production systems and the most experienced and knowledgeable authority on all aspects of the agricultural lands of Kekaha, Kauai where the Company's principal operations are located. Although the Company performs cross training among its technical staff and maintains various operational protocol documents, the specialized nature of the Company's marine biotechnical operations suggests that loss of key personnel could have a material adverse affect on the Company.

Shrimp diseases have had a serious economic impact on shrimp aquaculture operations worldwide, and the occurrence of an infection at the Company's operations would have a material adverse affect on its operations. The establishment of import bans on live shrimp by foreign countries to which the Company markets its shrimp hatchery products, or changes to air shipment regulations could negatively affect its ability to sell into these markets. Commercially available feeds of appropriate nutritional composition and acceptable price need to be shipped from off island suppliers to the farm. The unavailability of feed, large price increases, or interruptions in transport service would negatively affect the Company's operations.

All of the potential vectors of shrimp pathogens are not completely known. Contamination from infected broodstock and/or adjacent shrimp farms are understood to be the principal causes of infection. The Company has aggressively applied a disease prophylaxis strategy to prevent infection at its farm. When beginning operations, the Company first established its hatchery operation with state of the art animals known to be free of diseases associated with shrimp aquaculture, and committed to use exclusively its high health seed in all its farming operations. The location selected is an arid, isolated portion of Kauai, an island where no other shrimp farms exist, and seawater is drawn from deep seawater wells rather than directly from the ocean to preclude the incidental introduction of pathogens. The Company established rigorous quarantine and biosecurity procedures, a continuous pathological surveillance program, and health management protocols, and controls the transfer of materials, animals, vehicles and pedestrian traffic on its hatchery. To date, these and other disease prophylaxis strategies have been successful. Although such measures are considered the most effective means to ensure animal health, there is no absolute assurance against an incidence in the future.

Because the importation of infected broodstock is a key source of infection, several countries where shrimp farming is practiced have increased restrictions, adopted special animal quality assurance requirements, and in some cases temporarily banned importation of live animals. Management believes that, in general, such actions work in favor of the Company's marketing of its high health hatchery products because the Company's products have consistently passed tests based on the most rigorous standards of health quality. However, a substantial proliferation in the number shrimp farming countries instituting overall bans on the importation of live animals or changes in the regulations governing air shipment of live animals could negatively affect the foreign sale of the Company's products.

The capability to import appropriate feeds at acceptable prices is a risk that the Company has attempted to address through the establishment of relations with multiple feed vendors. Nonetheless, the cessation of business of any one of the specialized feed suppliers used by the Company, or substantial, industry wide changes in the economics of the feed industry, or the occurrence of labor strikes, which interrupt the shipping of feed, could negatively impact the Company's operations.

The Company's basic marketing strategy for its consumable product is to obtain a premium price by differentiating its shrimp from commodity grade product in terms of its superior taste, texture, cleanliness and freedom from chemical additives. In spite of this effort, if the world shrimp market is flooded with low priced commodity grade product, it is likely that the demand for the Company's product and the amount of premium the Company's product can command will fall temporarily. This is especially so for smaller sizes of shrimp, which are difficult to market as "premium shrimp." The Company's larger shrimp are less susceptible to price elasticity. Management believes that the

Company can further expand the base of customers willing to pay a higher price for its shrimp by improving the Company's ability to supply increased quantities of uniformly sized product on a regular basis. Expansion of the farm and development of the Company's own facility for processing, freezing were undertaken for these purposes; but until these expanded and improved facilities prove capable of meeting the demands of large scale end users consistently, the Company will remain subject to the uncertainties of global commodity price fluctuations which adversely affect the Company.

**PART II -- OTHER INFORMATION**

**Items 1, 3, 4, 5, and 6.** Not Applicable

**Item 2.**

Changes in Securities and Use of Proceeds

In April 2001, the Company received commitments from existing shareholders for up to $3.9 million in additional financing. The commitments are in the form of subscription agreements to purchase Dual Rate Convertible Debentures. The subscribers have deposited the funds in an escrow account. The Company may draw on the funds at such times and in such amounts as it may determine at any time until March 1, 2002. During the quarter ended July 31, 2001, the Company had draws from escrow totalling $1,950,000 and issued debentures in that principal amount. The debentures were sold in reliance upon exemptions from registration provided by Section 4(2) of the Securities Act of 1933 and Rule 506 of Regulation D promulgated thereunder.

All debentures that are issued will bear interest at the rate of 11.5% per annum from the date of issuance through March 1, 2002. Thereafter, the annual interest rate on outstanding debentures will be reduced to 3.0%. All interest earned from the date of issuance of a debenture through March 1, 2002, will be deferred and will be payable only upon redemption or through conversion into shares of the Company's common stock. Interest earned on outstanding debentures after March 1, 2002, will be payable quarterly by the Company, in arrears, and may not be deferred or converted into shares of common stock. Pursuant to the terms of the subscription agreements, the debentures are issuable in various denominations ranging from $25,000, or multiples thereof, to $100,000, or multiples thereof. The holders of the debentures have the right to elect to convert the full principal amount of their debentures together with all accrued interest from the date of issuance through March 1, 2002, into shares of the Company's common stock. In the event all $3.9 million in principal amount of debentures are issued and then converted by their holders into shares of common stock, the maximum number of shares the Company may be required to issue upon conversion would be approximately 6,100,000 shares at an average price of approximately $0.64 per share. Upon issuance, the shares will constitute “restricted securities” as defined in Rule 144 under the Securities Act of 1933.

**Signatures**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereto duly authorized.

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| | Controlled Environment Aquaculture Technology, Inc.<br>(Issuer) |
| Date: September 12, 2001 | By: /s/ Edward T. Foley<br>EDWARD T. FOLEY<br>Executive Vice President<br>Chief Financial Officer<br>(principal financial and accounting officer) |